DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 15428
San Diego, Calif. 92115

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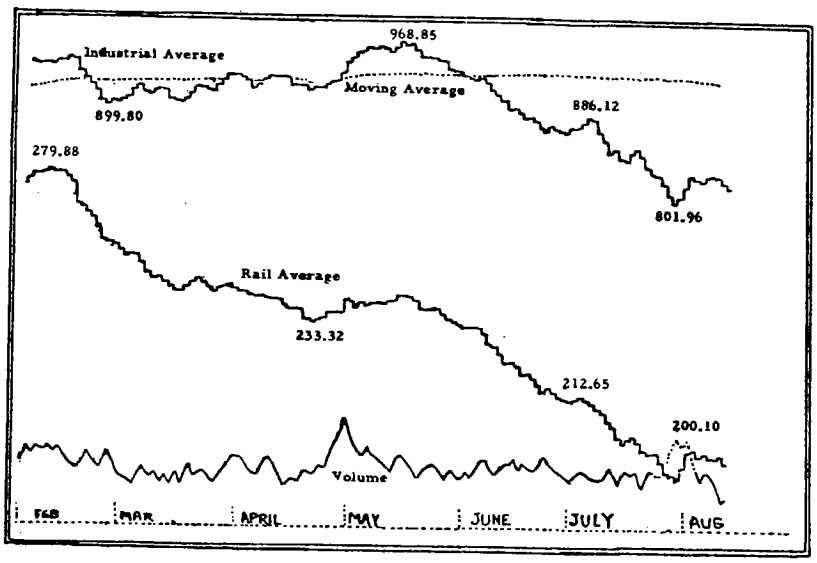
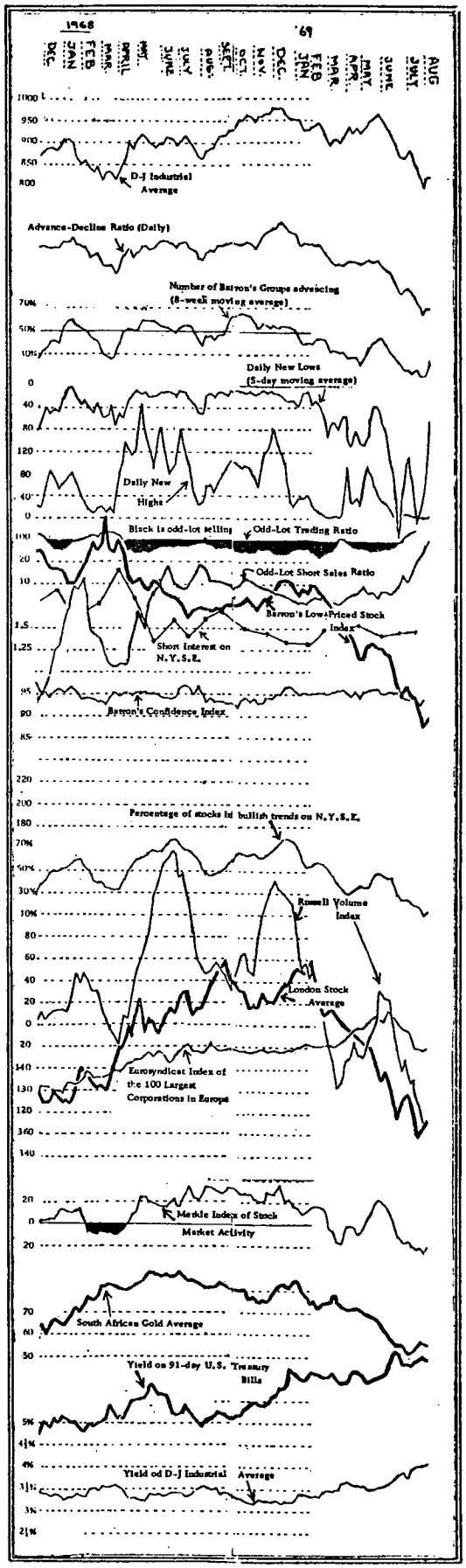
THE MARKET: From all accounts the optimists' blueprint for the market is this: The Averages are to "test" the July lows on reduced volume, then rally strongly to the 840 to 860 Industrial level. Following some hesitancy at 840-860, Industrials are to gather a following for a further recovery to around 900. From there on, it will be up to Mr. Nixon and the Federal Reserve Board. And maybe it will all happen that way.

The only thing which makes me dubious is that this is a primary bear market, and bear markets have a habit of crossing the optimists. The July lows for Industrials and Rails are 801.96 and 193.19 respectively. So far, the Averages are still holding above those levels and volume is running at greatly reduced levels.

Testing the lows on decreasing volume is a classic pre-rally indication in a bull market. But as Robert Rhea so often noted, dull spots during a primary bear market are usually "selling areas." Although Industrials and Rails are still holding above 801.96 and 193.19, it is notable that on August 11 the D-J Utility Average broke to a new low for 1969, thereby sinking to its lowest level since 1962. This is disconcerting action, particularly in view of the generally held opinion that "interest rates have seen their highs." As a rule, during a primary bear market (particularly in its early stages) a penetration of one Average is followed by penetrations in the other Averages.

The Utility Average plays no part in Dow Theory interpretation, but a study of history indicates that more often than not, the Utility Average may lead the trend. This is an even more reliable observation when the trend of the D-J Utility Average is confirmed by the D-J 40-Bond Average. The 1969 low for the 40-Bonds was 72.07. As this is written the 40-Bonds are only pennies away from a new 1969 low. Therefore, (although this is an admittedly subtle and seldom-followed indication), I would watch the 72.07 low for the 40-Bonds. With Utilities at new lows since 1962, I would take it as an ominous sign if the 40-Bonds confirmed by penetrating the 72.07 level.




1968
'69
D-J Industrial Average
Advance-Decline Ratio (Daily)
Number of Barron's Groups advancing (8-week moving average)
Daily New Lows (5-day moving average)
Daily New Highs
Black is odd-lot selling
Odd-Lot Trading Ratio
Odd-Lot Short Sales Ratio
Barron's Low-Priced Stock Index
Short Interest on N.Y.S.E.
Barron's Confidence Index
Percentage of stocks in bullish trends on N.Y.S.E.
Russell Volume Index
London Stock Average
Eurosyndicat Index of the 100 Largest Corporations in Europe
Merkle Index of Stock Market Activity
South African Gold Average
Yield on 91-day U.S. Treasury Bills
Yield od D-J Industrial Average

All in all, although the market has (so far) made a very sub-standard recovery from what Wall Street terms a "greatly over-sold condition," I continue to warn my subscribers against premature optimism. The primary trend is a law unto itself, and as the old adage runs, "the market can do anything."

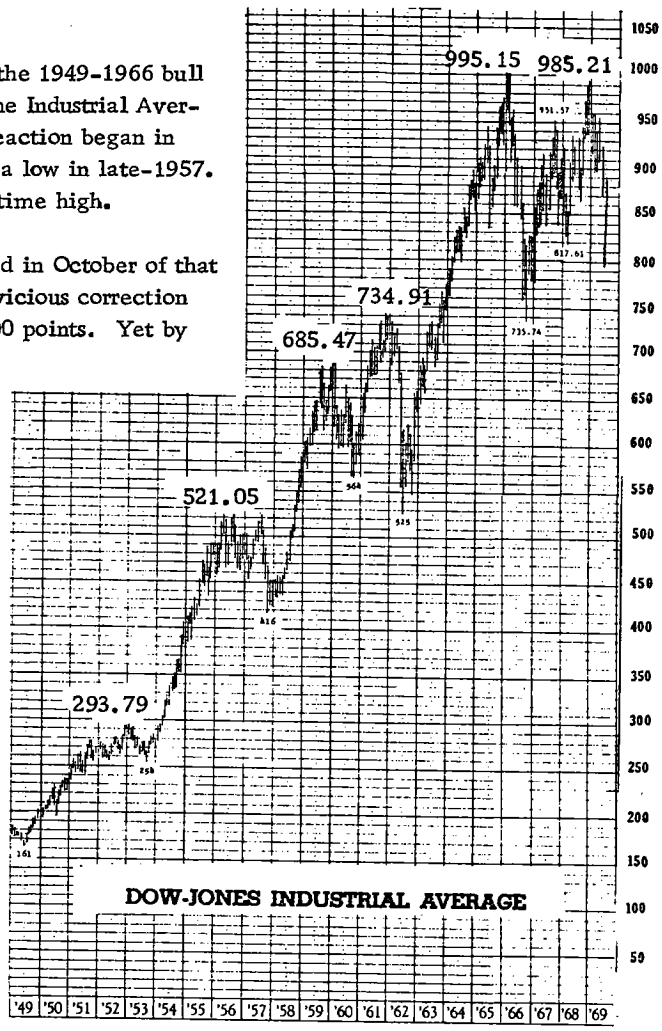
The fresh new low in Utilities is a negative indication. A new low by the 40-Bond Average would be doubly negative. But the proof of the pudding will be provided by the ability or inability of one or both Averages to hold above 801.96 (Industrials) and 193.19 (Rails). From our standpoint, it is fruitless to speculate on whether those lows will hold. The market will provide the answer in its own good time. But if the answer is that "the lows did not hold," the year 1969 is going to go down in the books as a very costly year on Wall Street.

SINCE THE TOP: Robert Rhea, the great Dow Theorist of the 1930's, always attached a great deal of importance to the timing of a movement. In my own research I have found timing to be an indispensable aid. For instance, a careful study of timing will show that the action since February, 1966 has been different from anything which has been seen since 1949.

Note on the accompanying chart that following the first reaction in the 1949-1966 bull market (the reaction which began in 1953 at 293.79 on the Dow), the Industrial Average turned up and moved to new highs within a year. The second reaction began in 1956, formed a "triple top" during 1956 and 1957, then smashed to a low in late-1957. By the end of 1958 the Industrial Average had rallied to another all-time high.

Again in January, 1960, a reaction began and the decline terminated in October of that year. By early 1961 the Industrials had recovered to new highs. A vicious correction started in December, 1961, and by June of 1962 the Dow had lost 200 points. Yet by September, 1963, the Industrial Average had surged to record highs again.

The advance continued until February, 1966. On February 9, 1966, the Industrial Average closed at an all-time high of 995.15. A downward movement followed, and the writer labeled this movement as the first leg in a new primary bear market. The decline ended at 744.32, 251 points under the 1966 bull market peak. A great recovery movement began from the late-1966 lows. By 1967 the Dow reached 943.08. A second decline occurred, following which the Dow pushed to 985.21 in December, 1968. Despite the fact that Industrials had recovered to within 10 points of their 1966 peak, despite the fact that Rails had pushed to a new all-time high, the market stalled again.



The events of 1969 are recent enough so that they do not have to be recounted here. But what I do want to remind subscribers is that it has now been three-and-one-half years since the 1966 bull market peak. Since 1949 every reaction has been followed by new all-time highs on the Dow within approximately a year. Yet now, three-and-one-half-years after the 1966 top, we find the Industrial Average approximately 170 points under its historic high.

This extended time lag implies that we are in a primary bear market. For despite all the inflation, the massive money expansion of 1966-69, despite the business boom and the greatest speculative spree in Exchange history, the Dow has failed repeatedly to better its 1966 bull market peak.

In my own mind there is only one conclusion. Wall Street, since 1966, has been caught in the grip of a greater force than anything which could be manufactured in Washington, at the Federal Reserve or anyplace else. That force is the tide of the primary bear market, and it is currently the single strongest influence on stock prices.

Since 1966 the bear tide has been fighting against a great business surge. It has been fighting the greatest expansion in the money supply ever seen. That the Dow could not get to new highs during 1966-1969 is subtle proof that the bear forces were stronger than all the power in Washington. But the strength of the bear has nevertheless been held back. The bear was not really ready to express itself.

In 1969 the bear started to stir. From the May, 1969 high of 968.85, a sweeping decline took Industrials to 801.96 on July 29. This represented a loss of 167 points in a little more than two months. By any standards, this was a violent decline.

It is important to note, however, that the 1969 low of 801.96 for the Dow was 57 points above the 1966 bear market low reading of 744.32. The 1969 low for Rails was 193.19, nine points above the 1966 bear market low of 184.34. If the primary bear market is to be re-confirmed, both Industrials and Rails will have to drop below their 1966 lows.

As stated before, three-and-one-half years have passed since the 1966 bull market top. This bear market, according to my studies, is running far behind schedule. But as I have so often observed in these reports, the longer a primary movement is held back, the more violent the action when the primary forces finally reassert themselves. Following this line of reasoning, if I had to hazard a guess I would guess that by the end of 1969 the Averages will have penetrated their 1966 lows of 744.32 and 184.34, respectively, and that the bear will be out in full view for all to see.

Perhaps I can put it another way. Most bear markets last around one-third as long as their preceding bull market. Considering that the 1949-1966 bull market lasted 17 years, we might guess that the bear market which began in 1966 will last about five or six years. This would put the bear market bottom around 1971 or 1972. With five months to go to 1970, the bear is obviously behind schedule. There is a good chance that the market is getting ready to make up for lost time. That is why I expect the next few years to prove singularly unpleasant for Wall Street.

As far as strategy is concerned, I continue to suggest about 85% to 90% in U.S. Treasury bills with the remainder in a hedge position in assorted gold shares. The rationale behind this mix was explained in the last Letter.

I have received a number of inquiries regarding short selling, and they run something like this: "If this is a primary bear market why don't you suggest short sales in selected stocks? What's the risk?"

My answer has always been based on simple observations of performance. I have known many men who have shorted the market, and I would say that four out of five ended up losing money. Shorting requires nerves of steel, precise timing, and a great deal of luck. Few men possess such gifts.

Incidentally, may I suggest that all subscribers read the article on the last page of the August 8 Wall Street Journal. The first paragraph begins, "The stock market decline of 1969 might look like a short-seller's dream but the professionals most inclined to hedge their investments by that route say it has often been more like a nightmare." The reasons are numerous and various, but among them professionals list: (1) difficulties caused by faulty timing, (2) shorting the wrong stock, (3) nervous pressure due to violent rallies and declines in a bear movement, (4) too many people trying to hedge in the wrong stock, (5) thinness of the market and lack of offerings on the required up-ticks.

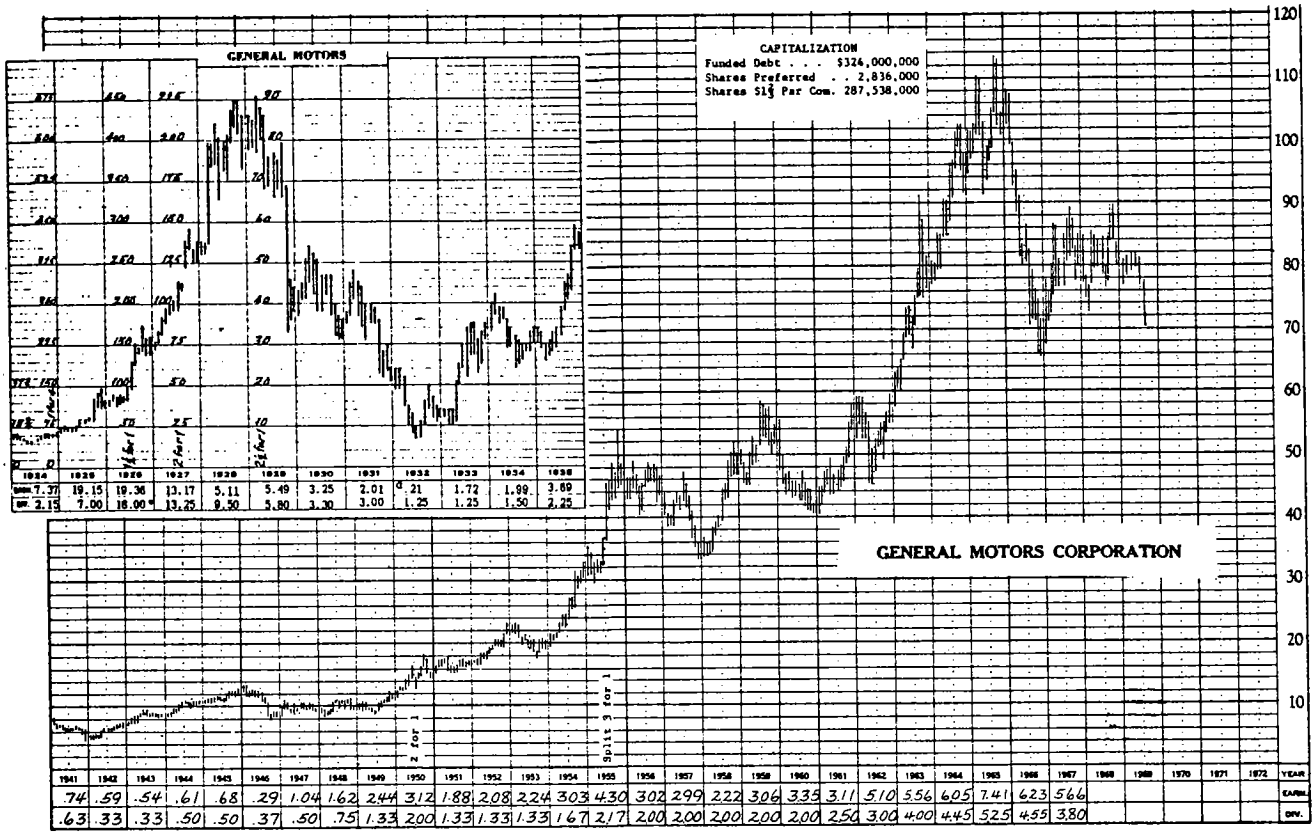
My advice: If the professional can't do it, there's probably a good reason. Shorting the market is far more apt to cost you money than make you money. As a hedge against declines it proves unsatisfactory in most cases.

Incidentally, the record of the so-called hedge funds has in general been worse during 1969 than that of most of the standard funds. "Among some of the private hedge funds," says the Journal, "asset losses this year have run to as much as 40% through July and setbacks of 25% to 35% are said to be fairly common."
(Chart of Dow courtesy of M.C. Horsey, Salisbury, Md. 21801).

GENERAL MOTORS: The price action of General Motors stock has always interested me. If there is one corporation which represents the hopes, miracles, and aspirations of American production and sales genius, it is GM. This has been true ever since the 1920's when the shares of this great company captured the imagination of the nation. That this is so is seen by the fact that GM's stock practically quintupled between 1926 and 1929.

I have included (page 4) two historical charts of GM, one covering the 1924-1935 period and one covering the period from 1941 to the present. Both charts show the monthly highs and lows for GM.

In the earlier period, the great advance in GM began in 1925. From a price of 45 in 1925, GM swept up to a March, 1929 peak of 680. This represented an increase of almost 1400%. During the 1929 crash GM fell back to 245, a loss of 64%. The stock then pushed up to a secondary peak of 405 in early 1930. For two years, during 1930 and 1931 GM built a giant "descending triangle" pattern of distribution. In late-1931 the second crash in GM stock occurred.



The run-up for GM began during the most recent bull market which began in 1949. From a price of around 9, GM surged to 60 in 1955. A long area of accumulation commenced, and by 1963 GM was off into new high territory again. The peak around 113 came in October, 1965. By late 1966 GM had broken under 66, a loss of 41% in the market value of GM.

Between late 1966 and up to the present, GM has been fluctuating in the 66 to 90 area. From the chart standpoint, the 1966-69 action in GM looks very much like the backing-and-filling action of GM during late-1929 to 1931. It should be remembered then when, in late-1931, GM broke its two-year base, the stock again plunged with an ultimate loss of another two-thirds of its value.

My own feeling is that if GM now breaks below its 1966 low of 65, it will mark the beginning of a drastic new decline, one which could take GM back to its 1960 base area of around 40. But if this is to be the case, I also feel certain that GM will take most of the rest of the market with it. GM is too big, it is too important to enter a bear market all on its own. Therefore, I consider the 65 level on GM critical for both the stock and the stock market. It is perhaps the one equity which can be termed a bellwether of the nation's economy.

(First chart of GM courtesy of F.W.Stephens, 87 Nassau St., N.Y.C. Second chart courtesy of M.C. Horsey, Salisbury, Md., 21801).

THE FRANC FALLS AGAIN: On August 8 France announced an 11.1% devaluation of the franc in terms of gold. Obviously, France felt that this was the largest devaluation she could put through without incurring the wrath of the international financial community. To my mind, the devaluation was not large enough for France's purposes. And from the nuisance standpoint, it remains to be seen whether the franc devaluation puts increasing pressure on the most vulnerable major currency, the pound.

One thing is immediately clear. The franc devaluation will make French products more attractive, and it will consequently hurt the British and American trade balances. My guess is that the effects of the latest fall of the franc will be gradual rather than sudden. But with the pound already anything but strong, I believe it makes another pound devaluation all but certain during the next year.

It also practically cancels the U.S.'s fondest wish, a revaluation of the very strong German mark. Since one of the major arguments for a revaluation (upwards) of the mark was that it would help the franc (and indirectly the dollar), the prospects of the reluctant Germans going along with a mark revaluation are now slimmer than ever.

But it should be remembered that every devaluation of an important currency means that gold is more valuable. It means that it takes more of the devalued currency to buy an ounce of gold. For me, the meaning of the franc devaluation is that the trend is still moving steadily towards a rise in the price of gold. In terms of the franc, the price of gold has just advanced. It is only a matter of time before the gold price is raised officially.....in terms of the dollar.

ECONOMIC MYSTERY: Economists now seem to be retreating into a state of total confusion. On one hand, we have those who are convinced that business is starting to retrench. They believe that the Federal Reserve Board (and the Administration) are perfectly willing to bring on a money-panic in order to slow inflation. They believe that the current decline in auto sales, private dwelling sales and durable goods orders are an omen of a general business slowdown to begin in the fourth quarter.

In fact, the Weekly Bond Buyer (August 4) carries an article which advances the opinion that the volume of commercial paper is now topping out. Commercial paper volume rose from $6 billion in 1962 to $26 billion in June, 1969. This represents an increase without parallel in financial history. Now, it is thought, the rush is nearing an end. Businessmen, sensing a decline in the economy, will cut back on commercial paper volume. So the theory goes.

A few other economists, led by Mr. Eliot Janeway, believe that this is not fated to be. Janeway believes that we are now in a summer lull and that after labor day business will pick up strongly again. He feels that the problems of the money market are far from over, and that interest rates may go still higher after labor day. As Janeway reads it, businessmen are getting the Federal Reserve's message, but contrarily they are running after money harder than ever. They are grabbing whatever money they can at whatever prices they have to pay—simply as insurance against the possibility of a money-panic. Thus, Janeway believes that business is getting the Fed's message but they are not reacting the way the Fed would like them to react.

Personally, I usually tend to be most intrigued by a contrary opinion. Therefore, it would not surprise me at all to see business engage on further expansion during the late summer and fall. It would not surprise me to see prices continue up, labor unions getting fatter contracts and the consumer still unwilling to face the possibility that the boom is doomed.

If Janeway's theory is true, then the Fed will be in a bigger quandry than ever come Autumn. Tight money will remain, and interest rates could even scale the 1969 peaks.

Ironically, either way the stock market finds itself on the horns of a dilemma. If business continues to expand the money market will remain tight and the stock market will have more of the same to contend with. On the other hand, if business starts actually contracting and volume of sales start sliding, the stock market will have to face sharply lower corporate earnings— perhaps far lower than anything now envisioned.

QUOTE OF THE WEEK: By Paul Volcker, Under Secretary of the Treasury for Monetary Affairs in an appearance before a House banking subcommittee: "For the present, the principle contribution that the United States itself can make to the stability of the international financial monetary system is perfectly plain— to bring our inflation to an end and to do so without sending shock waves of recession to every corner of the world. That is the main path we have set for ourselves, and none of us should be misled into thinking that some new monetary arrangement can dispense with fundamental need."

SIGNS OF THE TIMES: The August 15 issue of Life magazine features a cover story entitled, "The Dollar Squeeze." Life hired Louis Harris to conduct a poll on the people's reaction to taxes and the current financial situation. The poll, says Life, provides "a portrait of a silent, unblack, unurban, unaffluent America in seething revolt." Of those polled, 86% want cuts in Federal spending, a surprising 56% are willing to see wage and price controls brought in, 21% said they were willing to take part in a tax revolt. "One thing is certain," concludes Life, "(the politicians) had better start listening harder to what they (the people) say if they want to stay in office."

TAX BILL: So the House, in answer to the anguish of its constituents, has passed a tax reform bill. And now the trouble begins. In the August 11 issue of the Weekly Bond Buyers, feature writer Paul Hefferman states: "The tax reform bill, as passed by the House of Representatives, so dishonors Constitutional principles is so devoid of economic reality, and so worsens the most acute social and financial problems of the nation as to make a Presidential veto inescapable if the bill passes the Senate in its present form."

ECONOMIC SCRAPBOOK:

August 7.....Mortgaged ceilings (on interest rates) may be removed from certain Government-backed loans.
Three major producers, following the copper-price increases, raised the price of aluminum 1¢ per pound.

August 8.....The tax reform bill passed the House and is now heading for Senate debate.
The Commerce Dept. reported consumers are planning to buy more cars but less houses over the next six months.

August 11.....The French Franc was devalued 11.1% in terms of gold.
New business orders slowed noticably in July.
Paul McCracken, Nixon's chief economic advisor, stated that it was too early to ease up on monetary policy.

August 12.....Business inventories slowed their rise in June while sales expanded.
The British pound tumbled to its "floor" as speculation against the pound picked up.
Britain announced a July balance-of-payments loss of $89 million for July.
The Belgian franc turned increasingly weak and appeared to be a possible devaluation candidate as Belgian reserve dwindled.

PERSONAL NOTES: To Mrs. R. Boley of Arlington, Texas: I believe that the last issue should answer some of your gold questions. This year's S.D.R.'s will not even cover our deficit. To J.F. of Athenaz, Switzerland: I would get out of Eurodollar C/D's when and if the Dow breaks its 1966 low of 744.32. To Minis & Co.: I continue to read your reports with great interest. Many thanks. To A. Gilardi of Seattle: Your message confirms my knowledge that my subscribers include some of the real thinkers in this nation.

To Richard Irwin and others who ask for charts, here are two good sources: Quote Digest, 110 N. Lorrain, Wichita, Kansas. and Traders Research, 101 Cherry St., Alton, Ill. To Jacques Coe in Switzerland: I am taking the liberty of quoting part of your recent message, "The street gradually is undergoing a 'yardstick' metamorphosis. Two years ago 20 times earnings was normal—24 times excessive— and 16 times cheap. Gradually we should once more become accustomed to a 12 to 15 times denominator except, of course, for those companies which by reason of their 'unusual' products, can dream into the infinite." To Merle Voss of Calif. and L. Millikan: Thanks for the letters. To my friend Paul Klipsch: You and I should probably know that the market always does what it is supposed to do— but seldom when it is supposed to do it.

LATE NOTES: Since writing page 2, the 40-Bond Average has again slipped, and on August 13 it closed at 72.02, a new for the year and in fact a new low since 1933. Thus within the past week the D-J Utility and 40-Bond Averages have established new lows for the year, a bearish development.

Against this, it is noticable that a fair number of stocks are tracing out small potential reversal patterns. It is too early to tell, but the market could be in the process of building a secondary base with a low in the 800 area of the Dow.

A minor little peak was recorded in the Rail Average on August 4 at 200.10. My instinct tells me that this 200.10 level is extremely important from the short-term standpoint. Any rally in Industrials should be confirmed by a Rail bettering of the 200.10 level. Conversely, a persistent refusal by Rails to better that point would suggest to me that the Averages will be at new lows by the end of the year.